No. 85-668

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

WARREN G. WHEELER, JR., JEAN M. WHEELER, JAMES J. McLAUGHLIN, JR., And MARY K. McLAUGHLIN,

Petitioners,

v.

THE UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITIONERS' REPLY BRIEF

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The Brief For The United States In Opposition ["Respondent's Brief"] asserts that the Petition should be denied for the following reasons:

1. There is no conflict between the Court of Appeals decision and the *First Security Bank* case [*Petition, pages 7-8, 13*] because that case was decided under Section 482 of the Internal Revenue Code ["Code"] whereas this case involves Code Section 61 under which Petitioners may be taxed as "earners" of income.

2. *United States* v. *Basye,* 410 U.S. 441, is directly in point and renders *First Security Bank* irrelevant.

3. *Regan* v. *Taxation with Representation,* 461 U.S. 540, allows differential taxation of corporate employees and no inquiry need be made to determine if the discriminated-against employees and the benefited employees are members of the same class.

It is Petitioners' unequivocal opinion that Respondent grievously errs in all three of those assertions.

ARGUMENT

I

In the *First Security Bank* case, both this Court [405 U.S. 394 at 406, fn.22] and the Tenth Circuit [436 F2d 1192 at 1197] cited with approval *Teschner* v. *Commissioner,* 38 T.C. 1003 (1962), *Commissioner's appeal dismissed on his motion* (7th Cir. Docket No. 14157, 1963); *non acq.* 1964-1 CUM.BULL. 6. That case arose from a contest situation where a taxpayer-father had entered an essay contest and, being unable to qualify for a prize under the contest rules, designated his seven year old daughter to receive any prize which his entry might win. His entry won a fourth prize and his daughter received a $1,500 annuity policy which was to mature when she reached college age. The Commissioner assessed a deficiency against the father under Code Section 61 on the theory that the value of his daughter's annuity policy was compensation to him. Respondent primarily relied on *Lucas* v. *Earl,* 281 U.S. 111 (1930), *Helvering* v. *Horst,* 311 U.S. 112 (1940), and his own *Rev.Rul. 58-127,* 1958-1 C.B. 42.

On March 23, 1962, the Commissioner filed his Reply Brief in the *Teschner* case. It is believed that it included the Commissioner's first expression anywhere of his "generation of income" theory [Page 6, Reply Brief For Respondent filed in *Teschner* v. *Commissioner,* Tax Court Docket No. 90023]:

> "Respondents theory, correctly stated, is that whenever *A* receives something of value attributable to services performed by *B*, *B*, the earner, is the proper taxpayer. Petitioners would attribute to Respondent a theory both too broad and too narrow. Respondent's theory, correctly stated, would not tax to petitioners income paid to their daughter, but attributable to services performed by a stranger, but would apply with equal force to the facts of the present case even if the recipient were unrelated to petitioners."

The Tax Court, in a fully reviewed decision, held for the taxpayers. Observing that income taxes are imposed upon "the income of every individual" and that where an individual neither receives nor has the right to receive income he is not the taxable individual within the contemplation of the statute, the court responded to the Commissioner's theory that "earners" are the proper persons to be taxed [38 T.C. 1003 at 1007]:

> "If by this statement the respondent means that income is in all events includible in the gross income of whomsoever generates or creates the income by virtue of his own effort, the respondent is wrong. If this were the law, agents, conduits, fiduciaries, and others in a similar capacity would be personally taxable on the proceeds of their efforts. The charity fund-raiser would be taxable on sums contributed as the result on income generated for his employer by his efforts. Such results, completely at variance with every accepted concept of Federal income taxation, demonstrate the fallacy of the premise."

II

Not even the most attentuated analysis of *Basye* would justify a conclusion that an income tax may properly be assessed against one who "generates" income but never has a right or power to receive that income in due course. The

question there was whether *Partnership* income—not the incomes of the individual partners—could be assigned away in advance of its receipt. Partnership anticipatorily assigned away its right to receive that income within the meaning of all of the Supreme Court cases on the point. See Teschner, *Anticipation of Income*, 41 Indiana Law Journal 587-635 (1966).

It is less than candid for Respondent to use Basye in this case to advance its "generation of income" theory. The fact that the partners in *Basye* might never have received anything from the Partnership retirement trust was irrelevant to the question of whether there was partnership income, chargeable to the individual partners according to their respective distributive shares. It is hornbook law that "[a] partner is taxable on his distributive share of the partnership's income whether he receives it or not, or whether he is aware of its existence." *Melvin L. and Sherry Gold*, 1983-711 TCM, ¶ 83,711 P-H Memo TC 83-2965, 83-2968, 47 TCM 458, 460 (1983). See also, *Commissioner* v. *Goldberger's Estate*, 213 F.2d 78, 81-82 (3d Cir. 1954).

III

Respondent cites only this Court's *Taxation with Representation* ["*TWR*"] case to support its assertion that Petitioners' equal protection argument is "frivolous". That decision, however, *did* apply a classification standard before it further inquired into whether there was a rational basis for the classification [461 U.S. 540 at 548]:

> "*** The sections of the Internal Revenue Code here at issue do not employ any suspect classification. The distinction between veterans' organizations and other charitable organizations is not at all like distinctions based on race or national origin."

A critical difference of the *TWR* case from this one is that this is an income-inclusion case while there *TWR* justified the differential taxation of veterans' groups from other charities "*** because it wants to use tax-deductible contributions to support substantial lobbying activities." *461 U.S. 540 at 543-544.* As *Petition page 12* points out: "Two important federal tax cases of this Court distinguish the different equal protection inquiries mandated by income-inclusion cases—such as this one—and deduction cases."

Petitioners challenge absolutely Respondent's assumption that they agree "*** that the favorable treatment of tuition remission benefits bears a rational relationship to a legitimate governmental purpose." *Respondents' Brief, page 8.* Even though he did not make a preliminary inquiry into the classification standard, Chief Judge Kozinski also did not accept Respondent's stated rationale [*Petition, page A140, A144-A145, A148-A149, A155, A-185-186*]:

> [A140] "Here we have Purdue University swapping with Western Michigan University and do they make cash payments that can be taxed honestly like they ought to be. No. All they do is have little bookkeeping entries * * * which you know is bad, bad, bad, because it is supposed to be income on both sides."
>
> [A144-A145] "I realize that when it comes to dispensing tax benefits Congress has a lot of latitude, but there must be some limit to that and the fact there is a hue and cry from the college professors doesn't hardly seem to me to be a confirmation, reason enough for us to say there was a rational basis."
>
> [A148-A149] "Let's say Duke normally charges $8,000 a year. Why, under what theory would we say that Mr. McLaughlin and Mr. Wheeler got $2,000 worth of benefits because $2,000 was paid to have their children go to college and say that the college professor didn't get $8,000 worth of benefits because his wife or child decided to go to Duke, when everybody else has to pay $8,000. * * *
>
> "I mean, it is exactly the same case, it is exactly the same."

[A155] "THE COURT: I can't understand your [equal protection] argument. What is the rational basis?

"MR. PHILPOTT: It is the corresponding, the correspondence, the symmetry, the statutory symmetry."

[A185-A186] "I have a lot of trouble with the distinction drawn between the benefits afforded college professors and their families and apparently there are similar benefits afforded to the plaintiffs under this plan.

"Nevertheless, I am going to rule in favor of the defendant on that argument, as well, because I think it is a pure issue of law, ought to best be resolved by Circuit. I, myself, have very serious doubts on the point, but too much law has passed between 1933 and today for the Court to lightly overrule a regulation which has apparently the full support of Congress or, indeed, the direction of the Congress simply because I can't seem to understand why it makes sense."

What chief Judge Kozinski regarded as a "pure issue of law" was transmuted by the Court of Appeals into a factual question. That Court then speculated as to the facts and found that those reconstructed facts—albeit not supported by the Record—justified the differential taxation here in issue.

Respondent's position that differential taxation of corporate employees is permissible if their employers' respective businesses differ necessarily rejects the fundamental principle of equal protection as a limitation on the taxing power. In point of fact, however, equality should be the *sine qua non* of any tax code. Andrew Mellon, in his book *Taxation: The People's Business* (New York 1924), warned of the consequences of applying class legislation principles to tax law [14 *The Annals of America* 446 (Encyclopedia Britannica (1968)]:

"I have never viewed taxation as a means of rewarding one class of taxpayers or burdening another. If such a point of view ever controls our public policy, the traditions of freedom, justice, and equality of opportunity, which are the distinguishing characteristics of our American civilization, will have disappeared and in their place we shall have class legislation with all its attendant evils. The man who seeks to perpetuate prejudice and class hatred is doing America an ill service. In attempting to promote or to defeat legislation by arraying one class of taxpayers against another, he shows a complete misconception of those principles of equality on which the country was founded.***"

CONCLUSION

The Petition For A Writ Of Certiorari should be granted.

Respectfully Submitted,

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